VZCZCXRO6297
RR RUEHLMC
DE RUEHLM #0193/01 0561124
ZNR UUUUU ZZH
R 251124Z FEB 08
FM AMEMBASSY COLOMBO
TO RUEHC/SECSTATE WASHDC 7729
INFO RUCPDOC/USDOC WASHDC
RUEHNE/AMEMBASSY NEW DELHI 1855
RUEHKA/AMEMBASSY DHAKA 0745
RUEHIL/AMEMBASSY ISLAMABAD 7733
RUEHKT/AMEMBASSY KATHMANDU 5919
RUEHKP/AMCONSUL KARACHI 2328
RUEHCG/AMCONSUL CHENNAI 8344
RUEHGV/USMISSION GENEVA 2626
RUEATRS/DEPT OF TREASURY WASHDC
RUEHLMC/MILLENNIUM CHALLENGE CORPORATION

UNCLAS SECTION 01 OF 03 COLOMBO 000193

SIPDIS

SIPDIS

STATE FOR SCA/INS AND EB/TPP

STATE AND GENEVA PLEASE PASS TO USTR

MCC FOR S GROFF, D NASSIRY AND E BURKE

E.O. 12958: N/A
TAGS: ECON ETRD EFIN EAID CE
SUBJECT: SRI LANKA: EXPORTS TO U.S. DECLINE BUT STILL NINE TIMES IMPORTS FROM U.S.

REF: A. 07 COLOMBO 375 B. COLOMBO 166

¶1. (U) Summary: The United States merchandise trade deficit with Sri Lanka in 2007 was $1.84 billion. Sri Lanka's exports to the United States were $2.1 billion, while U.S. exports to Sri Lanka were $227 million -- a ratio of about nine-to-one. The EU replaced the United States as Sri Lanka's largest export market. A noteworthy development was the entry of U.S. wheat to Sri Lanka in 2007 after a lapse of several years. Sri Lanka's overall external sector performance was solid in 2007. Imports grew by 10% as the oil bill swelled for the third consecutive year. However, growth in exports, remittances, and government foreign borrowing helped Sri Lanka post a $500 million balance of payments surplus. End Summary.

U.S. $1.8 BILLION TRADE DEFICIT WITH SRI LANKA
--- --

¶2. (U) According to U.S. Department of Commerce Census Bureau statistics, U.S. exports to Sri Lanka in 2007 were $227 million. Against $2.06 billion in imports from Sri Lanka, the bilateral trade deficit was $1.84 billion. The nine-to-one flow of goods in Sri Lanka's favor was consistent with the level of recent years. Major U.S. exports in 2007 were electrical machinery, appliances, computers and parts ($48 million); wheat ($39 million); yarn and fabric ($21 million); medical equipment and measuring instruments ($15 million); plastic raw material ($13 million); paper ($7 million); and chocolate and cocoa preparations ($6 million).

¶3. (U) (Note: Embassy has requested Commerce Department assistance in examining the 2006 figure for U.S. exports, which was $237 million. Post believes the correct figure for 2006 may have been around $162 million. Post came to this conclusion during 2007 (subsequent to ref A) after noticing that 2006 data included an unusually large jump in U.S. machinery exports. Further inquiry indicated that the 2006 U.S. export figure included a $75 million oil drilling platform; post has confirmed that no oil platform was imported into Sri Lanka. If our analysis is correct, then, U.S. exports actually jumped 40% in 2007 -- from $162 million to $227 million. This discrepancy also means that the U.S. trade deficit with Sri Lanka in 2006 was larger than the $1.91 billion we reported. End note.)

SRI LANKA'S EXPORTS TO THE U.S. DECLINE

¶4. (U) Sri Lanka's exports to the United States in 2007 decreased by 4% to $2.06 billion or about a quarter of total exports. The U.S. share of Sri Lankan exports has gradually declined in recent years from over a third of total exports in 2005. The United States is now the second largest market for Sri Lanka's exports, after the European Union (EU). Apparel continued to dominate U.S.-bound exports, but decreased by about 6% to $1.6 billion. Other key exports from Sri Lanka to the United States were, in order, rubber, gems, machinery parts, tea, spices, plastic containers, and fish.

EXPORTS TO THE EU SURGE AGAIN;
EU BECOMES LARGEST MARKET

¶5. (U) Since 2006, the EU has been Sri Lanka's largest export market. In 2006, Sri Lanka's exports to the EU grew by 18%. In 2007, exports to the EU are likely (based on 11-month data) to have grown by an additional 20% or more, boosted by duty free access under the EU's Generalised System of Preferences Plus (GSP+) scheme. Under GSP+, the EU grants duty free access to Sri Lankan exports, including garments, in recognition of Sri Lanka's meeting international standards in human and labor rights, environmental protection, counter-drugs policy, and good governance. (Note: Human rights violations and other governance problems could cause Sri Lanka to lose eligibility for GSP+ when the EU reviews the program at the end of 2008. Ref B.)

EXPORTS OF APPAREL, TEA, AND
EMERGING SECTORS STRONG

¶6. (U) Sri Lanka's total exports in 2007 were $7.7 billion, 12.5% above the 2006 level. Apparel, Sri Lanka's largest export, increased 8.5% in 2007 to $3.34 billion, and accounted for 43% of all Sri Lanka's exports. The United States ($1.6 billion) and EU (about $1.4 billion) remain the key markets for Sri Lankan garments. Despite having had a good year, garment exporters are worried, fearing dramatic sales declines as a result of expiration of U.S. safeguards against Chinese apparel and the possible non-renewal of EU GSP+ status after 2008.

¶7. (U) Tea, Sri Lanka's second largest export after apparel, also had good results in 2007. Tea export earnings increased by 16%, surpassing $1 billion for the first time. Although the quantity of tea exported declined due to weather and other factors, record high tea prices produced the unprecedented export figure. Total agricultural exports were $1.5 billion (19% of total exports). Aside from garments and tea, there were positive signs of diversification of Sri Lanka's export base. Other exports (including food, rubber, spices, gems and various manufactured products) grew by 16% to $3.37 billion.

IMPORTS RISE RAPIDLY AS OIL BILL SWELLS AGAIN

¶8. (U) Sri Lanka's 2007 imports grew by 10% to $11.3 billion. The petroleum import bill swelled for the third consecutive year. Total cost of petroleum imports increased by 21% to almost $2.5 billion and accounted for a fifth of all imports. Food import costs increased by 11% to $1.06 billion. Sri Lanka imports staples like wheat flour, other cereals, sugar, milk products, onions, and dried fish. A small quantity of rice was also imported to meet a shortfall in 2007. Perhaps responding to hefty taxes, non-food consumer goods imports decreased by 8%. Sri Lanka has increased taxes on these imports (including motor vehicles) both to generate revenue and to protect local industries. Imports of investment goods such as building material, machinery, and transport equipment rose by 20% to $2.7 billion in 2007. Imports of intermediate goods (excluding oil), such as textiles and other industrial inputs and fertilizer increased by 3%, to a total of $4 billion.

TRADE DEFICIT EXPANDS BUT THANKS TO REMITTANCES
AND LOANS BOP REMAINS IN SURPLUS
--- --

¶9. (U) Sri Lanka's trade deficit grew at a slower rate of 6% to $3.6 billion in 2007 after expanding by 34% in 2006. The trade deficit was partly offset by higher worker remittances, which increased by about 15% to $2.5 billion. Foreign direct investment was around $600 million in 2007 compared with $480 million in 2006. Government foreign borrowing, including the $500 million first sovereign bond issue, also helped bring in cash. Consequently, the balance of payments recorded a surplus of around $530 million in 2007 compared with a surplus of $190 million in 2006. Total external reserves increased by 22% to $4.5 billion, sufficient to finance a healthy 4.8 months of imports. The Sri Lankan rupee ended 2007 with a marginal 1% depreciation against the U.S. dollar but depreciated much more heavily against the Euro.

COMMENT: 2008 COULD BE TOUGHER; NON-GARMENT
EXPORTS WILL HAVE TO PICK UP THE SLACK

¶10. (SBU) Sri Lanka ended 2007 with healthy reserves on the strength of its again high remittances, strong export performance, and increased international borrowing. A number of factors could drive each of these revenue sources down in 2008. A global economic slowdown would likely hit both remittances and exports, as workers abroad would earn less and consumers would buy less. A slowdown would also create tighter financial markets less inclined to lend money to emerging market countries like Sri Lanka. 2009 will almost certainly bring another challenge for Sri Lanka, with garment sales likely to be hit hard by the expiration of U.S. China safeguards and possibly by removal of the EU's GSP+ benefits. One positive 2007 development will cushion these impending blows: the fact that non-garment, non-tea exports exceeded the value of garment exports

for the first time in recent years. This indicates healthy diversification of Sri Lanka's exports, after many years of relying heavily on garments alone. USAID's Competitiveness Program deserves significant credit for this, after working with the tea, gem, rubber, ceramics, and spices sectors, among others, to improve their export performance. However the program wrapped up in 2007, so these sectors will have the opportunity to prove on their own that they can continue to generate export growth for Sri Lanka.
BLAKE